

## MINNESOTA Department of Revenue

**Interoffice Memorandum****Date:** October 23, 1997**Phone:** 282-5747**To:** Members of Task Force C - MTC Public Participation Working Group  
Definition of a Unitary Business.**From:** William J. Lunka, Corporate Technical Manager  
Corporate Franchise Tax Division**Subject:** Definition of a Unitary Business.

Enclosed please find a redraft of the definition of a unitary business for your consideration. This draft takes the approach that a unitary business exists when there is a flow of value between the corporations. Under this regulation, a flow of value is determined if any one of the following tests are met:

- The contribution or dependency test is met;
- There is a unity of operation and use;
- There is functional integration, centralization of management and economies of scale are present; or
- The corporations are part of a vertically integrated enterprise.

This approach encompasses all of the tests that have used by the courts to determine whether a unitary business exists, rather than relying on one test (the Mobil factors test) to determine whether a unitary business exists.

You will note that this regulation is drafted as though it would be incorporated into Minnesota regulations dealing with the corporate franchise tax. For example, the regulation uses the word "corporation", instead of the term "entities" which was used in the original MTC regulation. These differences can be adjusted to fit within the MTC regulation.

If you have any questions on this draft, please call me at (612)-282-5747.

**Multistate Tax Commission**  
**DEFINITION OF A UNITARY BUSINESS**

1 I. ***Application of Regulation.*** This regulation provides the standards for  
2 determining whether corporations related through ownership shall be taxed as a  
3 single unitary business as required under Minnesota Statute § 290.17, Subdivision  
4 4.

5 II. ***General Definition of Unitary Business.*** A unitary business exists among a  
6 group of corporations when:

7 A) Each of the corporation's voting stock is owned, either directly or  
8 indirectly, more than 50%, by a common owner or common owners  
9 including that common owner if it is a corporation; and

10 B) A flow of value exists.

11 III. ***Flow of value determined.*** A flow of value is present when any of the following  
12 tests are met:

13 A) ***Contribution or Dependency Test.*** The operation of one or more  
14 corporations is dependent upon, or contributes to, the operation of another  
15 corporation;

16 B) ***Unity of Operation and Use.*** There is a unity of operation and a unity of  
17 use between the corporations;

18 C) ***Functional Integration, Centralization of Management and Economies***  
19 ***of Scale Test.*** There is functional integration, centralization of  
20 management, and economies of scale between the corporations; or

21 D) ***Vertically Integrated Enterprise.*** The corporations are engaged in  
22 vertically integrated business activities.

23 IV. ***General Principals.*** The distinction between the four tests in Subpart III is not  
24 always precise. Certain relationships between corporations may satisfy any one or  
25 more of these tests.

26 V. ***Application of the Contribution or Dependency Test.*** A corporation is engaged  
27 in a unitary business with another corporation if it is dependent upon the other  
28 corporation, or if it contributes to the business of the other corporation. A  
29 corporation may make contributions to another corporation, and such corporation

30 may be dependent upon another corporation. For example, contribution or  
31 dependency includes, but is not limited to, such things as supplies of raw or  
32 manufactured materials, for technological contributions, or for financial  
33 contributions. A corporation is financially dependent upon another corporation if  
34 it cannot obtain financial resources from other sources at equivalent terms.

35 A) ***Contribution/Dependency Disjunctive.*** The contribution or dependency  
36 test is phrased in the disjunctive. As a result, if the activities of a  
37 corporation either contributes to the activities of another corporation, or  
38 are dependent upon the activities of another corporation, a unitary business  
39 exists.

40 VI. ***Application Of The Unity Of Operation And Unity Of Use Test.*** Under the  
41 unities test, the distinction between unity of use and unity of operation is not  
42 always precise. Certain relationships between corporations may satisfy either part  
43 of the test. The determination of whether a unitary business exists is made on the  
44 basis of an overall evaluation, and there is no prescribed level of unity of  
45 operation or unity of use which must be present in every case.

46 A) ***Description Of Unity Of Use.*** Unity of use is present when there is a  
47 centralized executive force and general system of operation. The  
48 distinction between a centralized executive force and general system of  
49 operation is not always precise. The determination of whether unity of use  
50 is present is made on the basis of an overall analysis of the evidence of  
51 centralized executive force and the evidence of a general system of  
52 operations. There is no prescribed amount of centralized executive force  
53 that must be exercised or no specific system of operations that must be  
54 present in a case before there is a finding of a unity of use.

55 i) ***Centralized Executive Force.*** Centralized executive force may  
56 flow from a parent corporation to a subsidiary corporation, from a  
57 subsidiary corporation to a parent corporation, or from any  
58 combination of the foregoing. A centralized executive force would  
59 include, but is not limited to, common officers or directors who

60 exercise control over the corporations. A centralized executive  
61 force may be implicit or explicit. Centralized executive force is  
62 present when management ensures that the corporations are  
63 operated for the benefit of all of the corporations within the group,  
64 not just for individual corporation's betterment. Centralized  
65 executive force is present when there is a transfer or rotation of  
66 officers or other management employees among the business  
67 segments.

68 ii) **General System Of Operation.** A general system of operation is  
69 present when corporations have common standards of  
70 professionalism, profitability, and/or ethical practices. A general  
71 system of operation include the use of common policies,  
72 procedures, directives, guidelines, etc., or the requirement that one  
73 corporation's budgets, contracts, capital expenditures and the like,  
74 are approved by another corporation. It would also include  
75 accounting and financial reporting systems that one corporation  
76 establishes or causes to be established for another corporation.

77 B) **Description Of Unity of Operation.** Unity of operation is present when  
78 operations among the corporations are centralized or coordinated through  
79 either line or staff functions. Unity of operations with regard to line  
80 functions includes, but is not limited to, a centralized manufacturing  
81 facility used by more than one corporation in the group. Examples of  
82 unity of operations with regard to staff functions include, but are not  
83 limited to, a centralized or coordinated legal function, purchasing function,  
84 a centralized accounting function, etc. utilized by more than one  
85 corporation in the group.

86 VII. **Application of the functional integration, centralization of management, and**  
87 **economies of scale test.** The distinction between the functional integration,  
88 centralized management and economies of scale is not always precise. Certain  
89 relationships between corporations may satisfy one or more of the factors. The

determination of whether a unitary business exists is made on the basis of an overall evaluation, and there is no prescribed level of each of the factors that must be present in each case. Application of these factors to the facts of each case will determine whether there is sufficient flow of value between the corporations so that the corporations function as a single unitary business.

A) ***Classification Of Functional Integration.*** Under the functional integration, centralized management and economies of scale test, a particular business activity may be classified in one or more of these factors. In these circumstances, it is unimportant whether the particular business operation is unambiguously classified as either functional integration, or centralization of management, or economies of scale.

B) ***Description Of Functional Integration.*** Functional integration is the transfer between or pooling of line or staff functions among corporations. Functional integration includes, but is not limited to, transfers or pooling of the corporations' products or services, technical information, marketing information, distribution systems, purchasing, or the transfer, pooling or otherwise sharing of intangible assets such as patents, trademarks, service marks, copyrights, and trade secrets, know-how, formulas, and processes.

C) ***Specific Type Of Functional Integration Not Required.*** There is no specific type of functional integration that must be present. Facts suggesting the presence of functional integration should be analyzed in combination for their cumulative effect and not in isolation.

D) ***Examples of functional integration.*** The following are some examples of functional integration. The order of the list does not establish a hierarchy of importance.

i) ***Transfer of goods and/or services.*** Sales, exchanges, or transfers (collectively "sales") of products, services, and/or intangibles between corporations is an example of functional integration. A flow of value is present if the corporations derives value from their relationships or from the transfer of such goods or services.

120 Functional integration is not negated by the use of a readily  
121 determinable market price to effect the intercompany sales.  
122 Intercompany sales can, for example, represent an assured market  
123 for the seller or an assured source of supply for the purchaser.

124 ii) **Common Marketing.** Common marketing programs or strategies  
125 among corporations is a form of functional integration. Common  
126 marketing exists when the corporations' products, services, or  
127 intangibles are jointly distributed or sold to a common customer or  
128 the sale of such products are coordinated. Common marketing also  
129 includes the use of common trade names or other common  
130 identification, or when corporations seek to identify themselves to  
131 their customers as a member of the same group of corporations.

132 iii) **Transfer or Pooling of Technical Information or Intellectual**  
133 **Property.** Transfers, pooling, or otherwise sharing of technical  
134 information or intellectual property, such as patents, copyrights,  
135 trademarks and service marks, trade secrets, processes or formulas,  
136 know-how, research, or development, indicate functional  
137 integration.

138 iv) **Common Distribution System.** The use of a common distribution  
139 system by the corporations such as centralized, inventory control  
140 and accounting, storage, trafficking, and/or transportation indicates  
141 functional integration.

142 v) **Common Purchasing.** The use of centralized or coordinated  
143 purchasing of products, services, or intangibles indicates functional  
144 integration.

145 vi) **Common or Intercompany Financing.** Common or intercompany  
146 financing, including the guarantee by, or the pledging of the credit  
147 of, one or more corporations for the benefit of another corporation  
148 indicates functional integration.

- 149           E)    **Description of Centralization of Management.** Centralization of  
150                   management exists when directors, officers, and/or other management  
151                   employees of one corporation participate in or make the management  
152                   decisions which affect other corporations. Centralization of management  
153                   can exist whether the centralization is effected from a parent corporation  
154                   to a subsidiary corporation, from a subsidiary corporation to a parent  
155                   corporation, from one subsidiary corporation to another, or from any  
156                   combination of the foregoing.
- 157           F)    **Day to Day Decision-making Not Required.** Centralization of  
158                   management exists between two or more corporations even when day-to-  
159                   day management responsibility and accountability for the individual  
160                   corporation has been decentralized, if management has overall  
161                   management control with respect to the corporations. Such overall  
162                   management control can be effected through mandates, consensus  
163                   building, implicit understandings of the overall operational strategy of the  
164                   corporations, or through any other mechanism.
- 165           G)    **Centralization of Management May Be Explicit or Implicit.**  
166                   Centralization of management can be explicit or implicit. Explicit  
167                   centralization of management includes, but is not limited to; the existence  
168                   of common officers, directors, or other key employees; the issuance of  
169                   mandates, policies, procedures, directives, or the exercise of control by  
170                   controlling or directing financial and/or other resources. Implicit  
171                   centralization of management includes, but is not limited to, the  
172                   management of the corporations through consensus building, implicit  
173                   understandings of the overall operational strategy of the enterprise.
- 174           H)    **Indications of Centralization of Management.** Centralization of  
175                   management is indicated when management of a corporation control the  
176                   operations of another corporation. (The order of the following discussion  
177                   does not establish a hierarchy of importance.) Centralization of  
178                   management exists when the management of one or more corporations

ensures the corporations are operated for the benefit of the group and not just for each corporation's own betterment. Centralization of management exists when a corporation's management transfers knowledge and expertise to another corporation. Centralization of management exists when common standards of professionalism, profitability, and/or ethical practices apply to the corporations, or the transfer or rotation of officers or other management employees among the corporations. The existence of common officers or directors who actively participate in the management of one or more of the corporations indicates the existence of centralization of management.

- I) ***Economies of Scale.*** Activity among and between corporations resulting in a significant decrease in the cost of operational or administrative functions due to the increase in operational size indicates economies of scale. Economies of scale may exist from the inherent cost savings that arise from the presence of functional integration or centralization of management. The following are examples of business operations that support the finding of economies of scale. The order of the list does not establish a hierarchy of importance.

i) ***Purchasing.*** Centralized or coordinated purchasing designed to achieve savings due to the volume of purchases, the timing of purchases, or the interchangeability of purchased items among the purchasing corporations indicates economies of scale.

ii) ***Administrative Functions.*** The performance of controlled or coordinated administrative functions, such as legal services, accounting, tax administration, pension and other employee benefit administration, and financial reporting, in common among the corporations may result in economies of scale. A corporation that secures savings in the performance of administrative services due to its affiliation with other corporations indicates economies of scale.



209 VIII. *Vertically Integrated Corporations.* When a group of corporations coordinate a  
210 process that occurs between the corporations, such corporations are engaged in a  
211 vertically integrated unitary business, or when such corporations are engaged in  
212 one or more steps in a business process that results in the transfer of goods or  
213 services, knowledge, or expertise through the steps of a process., or when a group  
214 of corporations For example, an enterprise engaged in the exploration,  
215 development, extraction, and processing of a natural resource and the subsequent  
216 sale of a product based upon the extracted natural resource, is engaged in a single  
217 unitary business, regardless of the fact that the various steps in the process are  
218 operated substantially independently of each other with only general supervision  
219 from the enterprise's executive offices.  
220